



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Date: [REDACTED]

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

NO PROTEST RECEIVED  
Release to Manager, NO Determinations - Cincinnati

DATE: [REDACTED]

SURNAME: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code ("the Code") as an organization described in section 501(c)(12). Based on the information submitted, we have concluded that you do not qualify for exemption under this Code section. The basis for our conclusion is set forth below.

You were formed in [REDACTED] as a non-profit corporation under the laws of [REDACTED]. Your founders were [REDACTED] and [REDACTED] ("the [REDACTED]"), and they were the initial and only members of your organization. In [REDACTED], the [REDACTED] purchased [REDACTED] acres of agricultural land to develop into a residential neighborhood. The [REDACTED] divided the land into plots for resale. The [REDACTED] paid for the construction of a water well and pipelines to provide water to the houses when constructed.

You were created to assume the ownership, operation, and maintenance of the water well and pipelines once the lots of land were sold, and houses constructed and occupied. The new residents would become the members of your organization. The [REDACTED] however, were unable to find buyers for the lots of land, and the residential development was not realized. In the interim, the [REDACTED] used the land for cattle grazing and wheat farming. The [REDACTED] retained ownership of the water system and used the system for their needs. Hence, you were inactive from [REDACTED] to [REDACTED] and, consequently, lost your corporate status (i.e., corporate power, rights, and privileges) under [REDACTED] law. In [REDACTED], you filed a Certificate of Revivor with the state to regain your corporate privileges and reinstate your corporate status to the date of original suspension. [REDACTED] became the sole member of your organization in [REDACTED].

You have no financial records from the tax years [REDACTED] to [REDACTED] because you were inactive. During these tax years, the [REDACTED] retained the ownership of the water system and paid for the operating cost, maintenance, repairs and capital improvements. You did not pay for any of these expenses. In your statement of revenue and expenses for the tax year [REDACTED], you do not have income from your sole member, [REDACTED], but incurred operating expenses of [REDACTED].

[REDACTED] You received \$[REDACTED] in "direct expense reimbursements" from [REDACTED]. You represent that "direct expense reimbursements" are those expenses over and above those associated with the normal course of business. You also represent that this expense category will cease once [REDACTED] has sold the lots of land. In tax year [REDACTED], your budget indicates that you have \$[REDACTED] income derived from water service and "direct expense reimbursements" in the amount of \$[REDACTED] from [REDACTED]. In tax year [REDACTED], your budget indicates that \$[REDACTED] will be used for water services, \$[REDACTED] will be used for road maintenance, and \$[REDACTED] will be used for "direct expense reimbursements."

#### Law

Section 501(c)(12) of the Code provides for the exemption from federal income tax of benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

In Rev. Rul. 67-265, 1967-2 C.B. 205, an organization was formed for the purpose of acquiring and maintaining a light and water distribution system. The revenue ruling holds that this organization is exempt under section 501(c)(12) of the Code because it is a like organization for purposes of section 501(c)(12). The revenue ruling reasons that furnishing water is a type of public utility service similar to those enumerated under section 501(c)(12).

Rev. Rul. 2002-54, 2002-37 I.R.B. 527 (S. pt. 16, 2002) states that public utility type service includes distribution water or sewage disposal service, provided the rates of which have been traditionally regulated by a state or the federal government. Further, a public utility type service, like the delivery of electricity from producers to consumers, requires an extensive infrastructure, the construction and maintenance of which requires a large capital outlay.

#### Discussion

Section 501(c)(12) of the Code specifically provides for the tax exemption of cooperative organizations that provide telephone service, electricity service or services "like" those provided by the preceding cooperative organizations, provided such an organization derived 85 percent or more of its income from members. Hence, an organization must satisfy three requirements in order to be recognized as exempt from federal taxation under section 501(c)(12) of the Code. First, it must conduct the activities described in section 501(c)(12), i.e., electric service, telephone service, or like activities. Second, it must derive 85 percent or more of its income from members. Finally, it must organize and operate in a cooperative manner.

Our first inquiry is whether you are conducting activities that are described in section 501(c)(12). We note that distribution of water in a cooperative manner by an organization to its members is an activity permitted under section 501(c)(12) of the Code. See Rev. Rul. 2002-54 and Rev. Rul. 67-265, supra. Our review of the facts in the administrative file and representations made clearly indicate that you are not, in reality, distributing water to members in a cooperative manner. Rather, you are organized and operated to help the [REDACTED] to develop lots of land for sale as a residential neighborhood. Our conclusion is supported by the

following: The [REDACTED] owned the water system. The [REDACTED] paid for the construction and maintenance of the water system. You were inactive for twenty years and lost your corporate status for those years. [REDACTED] regained your corporate status only when she decided there was a market for sales of the lots of land. You were merely an alter ego of the [REDACTED] organized to help facilitate the real estate development. Consequently, your activities are not those permitted by section 501(c)(12).

Assuming that your activities are those permitted under section 501(c)(12), you could not qualify for exemption under this Code section because you did not receive 85 percent or more of your income from members for the tax years in question. The 85 percent member income test is computed in each taxable year, and a cooperative may fail the test one year but meet the test in a prior or subsequent tax year. The 85 percent member income test requires that the income be (1) derived from members and (2) used to pay for services listed in section 501(c)(12). You were inactive and had no income for the tax years [REDACTED] through [REDACTED]. Hence, you failed the 85 percent member income test for these tax years. For the tax year [REDACTED], you received \$[REDACTED] from [REDACTED] to cover expenses incurred in the development of the real estate. Hence, this amount has no relation to the distribution of water and is nonmember income for purposes of calculating the 85 percent member income test. Therefore, you failed to satisfy the 85 percent member income test for the [REDACTED] tax year.

Since you do not conduct activities permitted under section 501(c)(12) of the Code and fail to satisfy the 85 percent member income test for the tax years 1981 through 2002, you, therefore, do not qualify for exemption as an organization described in section 501(c)(12) of the Code. You must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

[REDACTED]

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,  
(signed)

[REDACTED]

Manager, Exempt Organizations

[REDACTED]

cc:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]